

AUDIT DIVISION STATISTICAL STUDY

The following information is based on 100% of the audits completed, taxpayers assisted and special projects conducted during Fiscal Year 2003 and addresses the requirements set forth by IC 6-8.1-14-4(2).

See Page 60 for an index of exhibits and charts included.

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● TAXPAYERS SERVED IN DISTRICT OFFICES

Taxpayer assistance is available in all district offices. Each office has a taxpayer assistance supervisor and assistant taxpayer assistance supervisor who perform taxpayer service functions as well as other office support responsibilities. One office has a field investigator who supports taxpayer assistance. The investigator also performs collection functions in the district. Contract employees are available during peak periods to support taxpayer assistance.

The "Taxpayer Assistance Report" (Exhibit A) provides the number of taxpayers assisted (in person and by telephone) and the amount of money collected and assessed in each office by the taxpayer assistance program. Exhibit A reveals that during Fiscal Year 2003 district offices assisted 143,307 taxpayers in person and 175,419 taxpayers through telephone contact. Total taxpayers served by the district offices are 318,726. The district office in Columbus served 26,550 taxpayers in person, the highest number of any district office. The Clarksville District Office served 22,599 taxpayers in person, the second highest total.

The Columbus District Office served 23,913 taxpayers by telephone while the Bloomington District Office served 23,122 taxpayers by telephone. This was the highest number of telephone contacts among the district offices, totaling 27% of total taxpayer telephone contacts. The Columbus District Office served a total of 50,463 taxpayers by telephone and walk-in assistance while Clarksville served 40,958 taxpayers by telephone and walk-in assistance.

"Taxpayer Assistance/Special Project Statistics" (Exhibit B) provides the number of hours devoted by field auditors in the district offices to assist taxpayers and conduct special projects. The exhibit reveals that 21,503 auditor hours were channeled in this direction.

GROSS INCOME TAX VIOLATIONS

The most frequently violated gross income tax rule is 45 IAC 1.1-2-4. This rule defines taxable high rate income of utilities, display advertising, sale of real estate, rentals and extension of credit. Violations (49) of this rule accounted for 16.78% of all violations of the gross income tax rules in the statistics. Rule 45 IAC 1.1-2-4 was the third most violated rule in the 2001 report with 7.87%.

The second most frequently violated gross income tax rule is 45 IAC 1.1-2-5. This rule defines taxability of gross receipts from services. Rule 2-5 was inappropriately applied according to regulations affording taxpayers more exclusions from gross receipts. 45 IAC 1.1-2-5 produced 43 (14.73%) gross income tax rule violations. This rule was the most frequently violated gross income tax rule in the 2002 study (11.82%), 2001 study (16.03%) and 14.50% in the 2000 study.

Ranking third with 37 (12.67%) infractions of the gross income tax rule violations is Rule 45 IAC 1.1-2-2. This rule defines taxable low rate gross income of retail and wholesale sales, display advertising, dry cleaning and laundry service, rental of water softening equipment, rental of rooms, lodging, booths and similar accommodations and commercial printing. Rule 2-2 was the third most frequently violated rule in the 2002 study (9.09%). Refer to paragraph one in this category for 2001 data. For 2000, the third most violated rule was 45 IAC 1.1-1-10 at 8.85%. This rule defines receipts to mean the entire gross income or gross receipts received by a taxpayer, actually or constructively, without any deduction of any kind or nature.

SALES/USE TAX VIOLATIONS

The most frequently violated sales and use tax rule is 45 IAC 2.2-3-20. Rule 3-20 states that if the seller of tangible personal property for storage, use or consumption in Indiana fails to collect the appropriate tax, the purchaser of such property must remit tax directly to the Department. This rule produced 545 violations (14.67%) of the sales and use tax infractions. In the 2002 study, Rule 3-20 accounted for 12.72% of sales and use tax infractions and also ranked first. In 2001, 45 IAC 2.2-6-8, which discusses the determination of a retail merchant's liability for a report period, was violated 14.92% or 614 times.

The second most frequently violated sales and use tax rule is 45 IAC 2.2-3-4. Rule 3-4 imposes use tax on "tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used or otherwise consumed in Indiana...unless the Indiana state gross retail tax (sales tax) has been collected at the point of purchase." This rule accounted for 378 infractions or 10.18% of sales and use tax statute violations. The second most violated sales and use rule in 2002 was 45 IAC 2.2-5-8 (11.25%) (explained in next paragraph) 45 IAC 2.2-3-20 (explained above) was the second most violated rule in the 2001 and 2000 studies accounting for 500 and 664 violations respectively.

The third most violated rule for the 2003 fiscal year is 45 IAC 2.2-5-8. Rule 5-8 clarifies sales and use tax by providing examples of taxable and nontaxable sales of manufacturing machinery, tools and equipment used in direct production and other activities. Failure of taxpayers to comply with this rule accounts for 363 or 9.77% of the sales and use tax infractions. Rule 5-8 ranked second in the 2002 study with 535 infractions. Rule 3-4 with 481 violations ranked third in violations in 2001 study. Rule 8 also ranked third in the 2000 study accounting for 447 infractions.

CORPORATE ADJUSTED GROSS INCOME TAX VIOLATIONS

Corporate taxpayers violated adjusted gross income Rule 45 IAC 3.1-1-8 more than any other rule. This rule states that taxable income as defined in the Internal Revenue Code is modified in several ways to arrive at Indiana adjusted gross income. Violations (76) of this rule accounted for 14.10% of the total violations. Rule 1-8 was also the most violated rule in 2002 with 94 or 12.21% of total infractions and 2001 with 119 or 13.52% of total infractions. The 2000 report revealed Rule 1-97 ranked first for adjusted gross income infractions with a 22.00% violation rate. Rule 1-97 addresses returns and reports filed by withholding agents.

Rule 45 IAC 3.1-1-1 was the second most frequently violated rule under this study. This rule deals with determining Adjusted Gross Income for Individuals as defined in Section 62 of the Internal Revenue Code. These

violations (63) account for 11.69% of the total violations for 2003. 45 IAC 3.1-1-9 ranked second in the 2002 report with 10.26% of violations. Rule 1-9 discusses the net operating loss deduction in computing Indiana Adjusted Gross Income. 45 IAC 3.1-1-97 ranked second in the 2001 study with 115 violations accounting for 13.07% of the total violations.

The third most frequently violated rule is 45 IAC 3.1-1-9. Rule 1-9 is defined in the previous paragraph. Violations (61) of this rule accounted for 11.32% of the violations of adjusted gross income tax rules. The 2002 study revealed 45 IAC 3.1-1-97 ranked third with 72 (9.35%) of the violations. 45 IAC 3.1-1-9 was the third most violated rule in the 2001 study accounting for 90 or 10.22% of the violations of adjusted gross income tax rules. The 2000 violations of 45 IAC 3.1-1-9 also ranked third with 8.62%.

AMOUNTS OF TAX ASSESSED

Exhibits C, D and E display the amount of assessments (refunds) and violations of the gross income tax, sales tax and adjusted gross income tax administrative rules, respectively. "Total assessments" for any tax type represent gross assessments less amounts refunded.

The amount assessed or refunded for each of the most frequent violations and the percentage of the amount to total net assessments are presented below:

Gross Income Tax—Exhibit C:

| | Amount Assessed | Percentage of All Assessments |
|----------------|--------------------|----------------------------------|
| 45 IAC 1.1-2-4 | \$ 4,191,733 | 19.45% |
| 45 IAC 1.1-2-5 | \$10,448,087 | 48.48% |
| 45 IAC 1.1-2-2 | \$ 204,995 | .95% |

Sales/Use Tax—Exhibit D:

| | Amount Assessed | Percentage of All Assessments |
|-----------------|--------------------|----------------------------------|
| 45 IAC 2.2-3-20 | \$ 1,864,866 | 5.72% |
| 45 IAC 2.2-3-4 | \$ 7,683,162 | 23.57% |
| 45 IAC 2.2-5-8 | \$10,609,315 | 32.55% |

Corporate Adjusted Gross Income Tax—Exhibit E:

| | Amount Assessed | Percentage of All Assessments |
|----------------|--------------------|----------------------------------|
| 45 IAC 3.1-1-8 | \$ 4,166,467 | 18.69% |
| 45 IAC 3.1-1-1 | \$ 418,944 | 1.88% |
| 45 IAC 3.1-1-9 | \$(6,531,316) | (29.30%) |

INDUSTRY/BUSINESS MOST FREQUENTLY IN VIOLATION

Gross Income Tax

For the eleventh consecutive reporting period, taxpayers engaged in manufacturing most frequently violated the gross income tax rules. This group committed 72 violations or 24.66% of the total violations. The gross income tax rule most frequently violated by this group of taxpayers was 45 IAC 1.1-2-2. This rule defines retail and wholesale sales; display advertising; dry cleaning and laundering; rental of water softening equipment; rental of rooms and facilities; and commercial printing.

The second largest number of gross income tax violations was committed by taxpayers providing information, publishing, telecommunications, finance, rental, insurance, real estate, leasing and professional services. This group committed 69 infractions or 23.63% of the total violations for 2003. The most frequently violated rule of this group was 45 IAC 1.1-2-4.

Sales and Use Tax

For the 2003 reporting period, repair, personal services and other services are the industries with the most infractions. They accounted for 854 violations or 22.99% of the total sales and use tax violations. The most frequently violated rule by these taxpayers was 45 IAC 2.2-3-20, which deals with remitting use tax on transactions where the seller does not collect the sales tax.

Wholesale, retail and transportation businesses had the second highest frequency of violations for the sales and use tax rules. There were 615 violations committed by this group representing 16.56% of the total violations. The rule most frequently violated by this group was 45 IAC 2.2-3-4, which imposes use tax on "tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used or otherwise consumed in Indiana...unless the Indiana state gross retail tax (sales tax) has been collected at the point of purchase."

Adjusted Gross Income Tax

Repair, personal service and other service providers with 138 infractions, were the most frequent violators of adjusted gross income tax rules. This figure represents 25.60% of the total adjusted gross income tax violations. 45 IAC 3.1-1-1, which defines adjusted gross income for individuals in relationship to Section 62 of the Internal Revenue Code, accounted for the most infractions in this class.

The manufacturing industry ranked second in violation of the adjusted gross income rules. They committed 119 infractions or 22.08% of the adjusted gross income tax violations. 45 IAC 3.1-1-8 was the most violated rule by these industries. Rule 1-8 discusses modifications of taxable income defined in the Internal Revenue Code Sections to arrive at Indiana Adjusted Gross Income.

SPECIAL TAX VIOLATIONS

Exhibit G provides the number of special tax rule violations and the amount of special tax assessments and refunds.

Article VIII (citation R800 on exhibit) of the International Fuel Tax Agreement (IFTA) was the most frequently violated special tax item in the study. It specifies the taxable event is the consumption of motor fuels in the propulsion of qualified motor vehicles, except fuel consumed that is exempt from taxation by a jurisdiction. All motor fuel acquired that is normally subject to consumption tax is taxable unless proof to the contrary is provided by the licensee. Article VIII was violated 190 times and yielded \$600,120 in net assessments for the State of Indiana. This represents 26.46% of total violations.

The exhibit also reveals that Article X (citation R1000 on exhibit) of the International Fuel Tax Agreement (IFTA) was the second most frequently violated section of the special tax statutes. This article discusses how taxpayers can obtain credit for tax previously paid on purchases of fuel at the pump. It also lists the records needed to substantiate the refund request. This article was violated 182 times accounting for 25.35% of the total violations. These violations resulted in a net refund of (\$12,902).

The taxpayer group most frequently in violation of the special tax statutes and IFTA Articles was the wholesale, retail and transportation industries. This group committed 417 violations accounting for 58.08% of the total infractions. Article VIII of the International Fuel Tax Agreement was most frequently violated by the wholesale, retail and transportation industries.

MISCELLANEOUS CODE VIOLATIONS

Exhibit F provides the number of violations and assessment amounts of the following:

Financial Institutions Tax
Tax Administration
Food and Beverage Tax
Innkeeper's Tax

A review of this exhibit reveals that IC 6-8.1-9-1 was violated 57 (18.45%) times in the 2003 study. This code section addresses filing claims for refunds, time limitations, hearings and appeals for refunds. These violations yielded (\$2,491,064) in net refunds. IC 6-8.1-4-2 was the most violated rule in the 2002 study with 24 (14.46%). This code section addresses access to accounting records of a business and the use of sampling techniques for auditing purposes. 45 IAC 15-9-2 was the most violated rule in the 2001 study. Rule 9-2 defines the statute of limitations as it applies to refunds.

The 31 violations of 45 IAC 15-9-2 yielded a total of \$279,085 in assessments. Rule 9-2 is defined above. Rule 9-2 was the second most violated citation in the 2002 and 2001 studies.

NUMBER OF YEARS IN THE AUDIT PERIOD

The audit period consistently averages three years.

USE OF PROFESSIONAL TAX PREPARATION ASSISTANCE

The services of professional preparers were used in the preparation of 75.50% of the corporate income tax returns and 11% of the sales tax returns. These findings remain consistent with the previous years' reports.

FILING OF APPROPRIATE TAX RETURNS

Rule 45 IAC 3.1-1-92 (Exhibit E) requires qualifying corporations to make estimated tax payments. Taxpayers in violation of this rule either failed to file estimated income tax returns or failed to remit the appropriate amount of tax. For Fiscal Year 2003, the study indicates 8 violations of this rule, resulting in assessments in the amount of \$12,863 and refunds totaling (\$110,617).

Indiana Code 6-8.1-10-2.1 (Exhibit F) revealed no violations during the 2003 study period. This section specifies the penalty to be imposed if a taxpayer fails to file an appropriate return or pay the full amount of tax due. Violations of this section in the 2002, 2001, 2000 and 1999 studies were zero while the 1998 report showed one violation.

SPECIAL PROJECTS

Two special projects were pursued during the 2003 Fiscal Year. One project identified taxpayers with delinquent filing periods. The second project identified delinquent taxpayers with outstanding Best Information Available liabilities. Examination of data generated by these projects identified and closed inactive business accounts; encouraged delinquent taxpayers to file correct returns; and collected substantial funds related to the filings.

Accounts Worked: 14,406 Accounts Closed: 3,425 Funds Collected: \$10,584,540

EXHIBITS

AUDIT DIVISION

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| Taxpayers Served in District Offices | | Page 61 |
| Field Auditors Taxpayer Assistance/Special Projects | Exhibit B | Page 62 |
| Standard Industrial Codes | | Page 62 |
| Dollars Assessed in 45 IAC Citations by Industrial Code Gross Income Tax Audits | Exhibit C | Pages 63 |
| Gross Income Tax Violations by Industry Group | | Page 64 |
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| Dollars Assessed in 45 IAC Citations by Industrial Code Sales and Use Tax Audits | Exhibit D | Pages 65-66 |
| Sales and Use Tax Violations by Industry Group | | Page 67 |
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| Dollars Assessed in 45 IAC Citations by Industrial Code Adjusted Gross Income Tax Audits | Exhibit E | Page 68 |
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| Dollars Assessed for Miscellaneous Code Violations by Industrial Code | Exhibit F | Page 70 |
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COMPLIANCE DIVISION

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2002 INDIANA INDIVIDUAL INCOME TAX BREAKDOWN BY FILING METHOD

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